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DEPARTMENT OF AUDITOR-CONTROLLER

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April 21, 2010

TO: Supervisor Gloria Molina, Chair
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FROM: Wendy L. Watanabe Wendy L. Watanabe
Auditor-Controller

SUBJECT: **FISCAL REVIEW OF FIELDS COMPREHENSIVE YOUTH SERVICES, INCORPORATED – A GROUP HOME FOSTER CARE CONTRACTOR**

At the request of the Department of Children and Family Services (DCFS), we reviewed the fiscal operations of Fields Comprehensive Youth Services, Incorporated (Fields or Agency) from January 1, through December 31, 2008. Fields is licensed to operate two group homes (GH), each with a resident capacity of six children. Fields' group homes are located in San Bernardino County. During our review period, the Agency cared for an average of eight children a month from Los Angeles County.

DCFS and the Probation Department (Probation) contract with Fields to care for foster care children placed in the Agency's homes. Los Angeles County paid Fields $5,092 per child per month, based on a rate determined by the California Department of Social Services for a total of $506,910 for calendar year 2008.

Scope

The purpose of our review was to determine whether Fields complied with the contract terms and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures. We also evaluated Fields' expenditure and revenue documentation, internal controls and compliance with applicable federal, State and County guidelines governing GH foster care funds.

Summary of Findings

We identified $21,112 in unallowable costs and $13,761 in unsupported/inadequately supported costs. In addition, DCFS and Fields need to work together to resolve some potential overpayments.

Fields' audited financial statements as of December 31, 2007 show an operating loss of $180,228 and $284,464 in negative net assets. The unaudited Balance Sheet as of December 31, 2008 shows negative net assets of $329,865, an increase of $45,401 from the previous year. Fields also owes $17,904 in delinquent federal payroll taxes, penalties and interest for the quarterly tax periods ended March 2006, June 2006, and September 2007. If Fields continues to incur operating losses, it is unclear how the Agency will maintain an adequate level of care while addressing its losses and paying its delinquent tax liability since the Agency has no reserves.

We have recommended that DCFS resolve the questioned costs and collect any disallowed amounts. Fields also needs to prepare a cost allocation plan, properly classify agency workers as employees, and strengthen its internal controls over cash disbursements and bank reconciliations. In addition, Fields also needs to submit their 2008 Semi-Annual Expenditure Reports to DCFS.

The findings in this report are significant and Fields needs to provide DCFS with a corrective action plan to address the recommendations. The corrective action plan must demonstrate how the Agency will continue to provide an adequate level of care while addressing its operating losses. The plan also needs to address how Fields will pay its delinquent tax liabilities since the Agency cannot use current period foster care funds to pay prior period liabilities.

Details of our findings are discussed in the attached report.

Review of Report

We discussed our report with Fields' management on June 3, 2009. The Agency generally agreed with our findings and recommendations. On October 20, 2009, the Agency signed a repayment agreement with Los Angeles County to repay DCFS the unallowable and unsupported/inadequately supported costs on a monthly basis over a five-year period. We thank Fields' management and staff for their cooperation during our review.

This audit is not intended to be, and does not constitute, the discovery or identification of an overpayment for purposes of the federal Improper Payments Act, related California State laws, including but not necessarily limited to Welfare and Institutions Code sections 11466.23, 11466.235, 11466.24, etc., nor State regulations intended to implement either the federal Improper Payments Act or related provisions in State law.

This audit is intended solely to assist the County Department of Children and Family Services in managing its contractual relationships. Consequently, this report will be forwarded to County Department of Children and Family Services in order that it might take further action, as it deems appropriate, based on its contents. Such further action may, or may not, include the discovery or identification of an overpayment for purposes of federal or State law.

Please call me if you have any questions, or your staff may contact Jim Schneiderman at (213) 253-0101.

WLW:MMO:JLS:MWM

c: William T Fujioka, Chief Executive Officer
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Audit Committee
Commission for Children and Families

Fields Comprehensive Youth Services, Incorporated
Fiscal Review

REVIEW OF EXPENDITURES/REVENUES

We identified $21,112 in unallowable costs and $13,761 in unsupported/inadequately supported costs. In addition, DCFS and Fields need to work together to resolve some potential overpayments. Details of these costs/overpayments are discussed below.

Applicable Regulations and Guidelines

Fields is required to operate its GH in accordance with the following federal, State and County regulations and guidelines:

- GH Contract, including Exhibit C-2, the Auditor-Controller Group Home Contract Accounting and Administration Handbook (A-C Handbook)

- Federal Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations (Circular A-122)

- California Department of Social Services Manual of Policies and Procedures (CDSS-MPP)

- California Code of Regulations, Title 22 (Title 22)

Unallowable Costs

We identified $21,112 in unallowable expenditures:

- $11,581 in late fees and finance charges.

- $7,641 in delinquent federal payroll taxes, penalties and interest for the quarterly tax periods ending March 2006, June 2006 and September 2007.

- $1,890 in bank overdraft and non-sufficient fund (NSF) fees.

Circular A-122 Sections 16 and 23 state that penalties and interest are unallowable costs. Using current period foster care funds to pay prior years' delinquent taxes is an unallowable use of funds.

Unsupported/Inadequately Supported Costs

A-C Handbook Section A.3.2 states that all expenditures shall be supported by original vouchers, invoices, receipts, or other supporting documents, and that unsupported expenditures will be disallowed upon audit.

We identified $13,761 in inadequately supported costs involving payments on lines of credit, gasoline, storage space, security system, auto repairs, groceries and utilities (i.e., cable service, electricity, and telephone). Some of the electricity costs were for a home in Hesperia, California, which did not provide service to Los Angeles County foster children. The Agency provided cancelled checks and charge card statements, but no receipts, or the receipts provided were inadequate to substantiate that the expenditures were program related.

As discussed in the "Allocation of Costs" section of this report, Fields does not have a plan to allocate its costs among its funding sources. As a result, it is possible that some of the questioned costs discussed in this section were related to the GH programs of other counties. Once the Agency develops a cost allocation plan, DCFS should determine the appropriate amount of unallowable and unsupported/inadequately supported costs that should be recovered.

On October 20, 2009, the Agency signed a repayment agreement with the Los Angeles County for the entire unallowable and unsupported/inadequately supported cost to be repaid monthly within five years.

Recommendations

1. **DCFS management resolve $34,873 ($21,112 + $13,761) in questioned costs and collect any disallowed amounts.**

Fields' management:

2. **Ensure that foster care funds are used for allowable expenditures to carry out the purpose and activities of the Agency.**

3. **Consistently maintain adequate supporting documentation for all Agency expenditures, including original itemized receipts, invoices and vehicle mileage logs.**

FIELDS' FINANCIAL CONDITION

Fields' audited financial statements as of December 31, 2007 show a $180,228 operating loss for the year and $284,464 in negative assets. The unaudited Statement of Financial Position (SFP) as of December 31, 2008 shows $329,865 in negative net assets, an increase of $45,401 from 2007. The unaudited SFP also shows liabilities to Los Angeles County and Riverside County for foster care overpayments, and to the federal government for delinquent payroll taxes. It is unclear how the Agency will be able to address these liabilities and any future operating losses that may occur since the Agency has no reserves and minimal cash or other liquid assets. Fields' financial condition could affect its ability to provide an adequate level of care to placed children.

Fields' management needs to develop a plan demonstrating how it will continue to provide an adequate level of care while addressing its financial issues. DCFS must carefully monitor the Agency to ensure that service quality is maintained at an acceptable level.

Recommendations

4. **Fields' management develop a plan demonstrating how it will provide an adequate level of care while addressing its financial issues.**

5. **DCFS management carefully monitor the Agency to ensure that service quality is maintained at an acceptable level.**

PAYROLL TAX LIABILITY

On January 7, 2009, the Agency established an agreement to repay the federal government $17,904 in delinquent payroll taxes, penalties and interest for the quarterly tax periods ended March 2006, June 2006 and September 2007. Of this total, $2,582 was for penalties and $2,314 was for interest. The repayment agreement indicates that the Agency will pay $1,100 a month. Because the Agency has negative net assets of $329,865 as of December 31, 2008, it is unclear how the Agency will pay the delinquent tax liability without using current period foster care contract funds. Current period foster care contract funds cannot be used to pay a liability that originated during a prior contract term. Fields' management should submit a plan to DCFS demonstrating how the Agency will repay its payroll tax liability without using current period funds. In addition, under Circular A-122 Sections 16 and 23, foster care funds can not be used to pay penalties and interest.

Recommendations

6. **DCFS management ensure that foster care funds are not used to pay penalties and interest.**

7. **Fields' management submit a plan to DCFS demonstrating how the Agency will pay its payroll tax liability without using current period funds.**

POTENTIAL DCFS OVERPAYMENTS

Fields' audited financial statements as of December 31, 2007 show a $145,000 liability for overpayments to Los Angeles County. DCFS records show additional potential overpayments. DCFS should collect the overpayments shown in Fields' audited financial statements. In addition, DCFS and Fields should work together to resolve any additional potential overpayments, and DCFS should collect any verified overpayments.

Fields' management should ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.

Recommendations

8. **DCFS management collect the overpayments shown in Fields' audited financial statements.**

9. **DCFS management work with Fields to resolve any additional potential overpayments and collect any verified overpayments.**

10. **Fields' management ensure that any future payment discrepancies are immediately reported to DCFS and any excess amounts are repaid promptly.**

ALLOCATION OF COSTS

A-C Handbook Section C.2.0 states that an agency should allocate expenditures that benefit multiple programs or funding sources on an equitable basis. During our review period, Fields operated the group home program and received funding from Los Angeles, San Bernardino and Riverside County.

The Agency records all administrative costs at the group home program level but does not allocate the costs to the individual counties. Fields should develop a plan to allocate administrative expenses to each county on an equitable basis.

Recommendation

11. **Fields' management develop a plan to allocate administrative expenses to each county on an equitable basis.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We noted the following internal control weaknesses during our review.

Accounting and Disbursement Procedures

We noted the following issues with the Agency's accounting and disbursement procedures:

- Four checks, totaling $4,741 were payable to cash. A-C Handbook Section B.2.1 states that checks should not be made payable to cash.

- Eighteen (20%) of 90 expenditures reviewed were not properly classified on the general ledger. For example, one item classified as clothing expense on the general ledger should have been classified as an office expense based on the receipt. A-C Handbook Section A.2.5 indicates that an agency must post transactions of a similar nature to the same account.

- Fifty-one (57%) of 90 expenditures reviewed were not marked "paid" and check numbers were not referenced to supporting documents. A-C Handbook Section B.2.1 states that all supporting documentation should be referenced to check numbers and marked "paid" or otherwise cancelled to prevent reuse or duplicate payments.

Recommendations

Fields' management:

12. Ensure checks are not made payable to cash.

13. Properly classify expenditures on the general ledger in a consistent manner.

14. Ensure supporting documentation are consistently referenced to check numbers and marked "paid" or otherwise cancelled to prevent reuse or duplicate payments.

Child Care Workers

A-C Handbook Section A.2.6 requires an agency to comply with Internal Revenue Service (IRS) guidelines by properly classifying employees and independent contractors. According to the IRS guidelines, an employee is a person who is generally subject to business instructions as to when, where and how to work, and is generally guaranteed a regular wage amount for an hourly, weekly or other period of time.

Fields has outsourced its payroll function. According to an internal memo and a written agreement with the payroll contractor, some of Fields' Child Care Workers (CCW) are treated as employees of the payroll contractor. The memo states that the contractor is liable for reporting and paying payroll taxes for these CCWs. However, based on discussions with Fields' Administrator and a review of Fields' payroll records, we noted that the CCWs were interviewed, hired, trained and instructed on how, when and where to work by Fields.

Based on the IRS guidelines, it appears the CCWs should be considered employees of Fields, not employees of the payroll contractor. Misclassification of employees may subject Fields to penalties and interest by the taxing authorities. Fields management should consult with the IRS to determine what actions are necessary to reclassify the

CCWs as its employees and ensure that the appropriate payroll taxes have been paid. DCFS management needs to ensure that no foster care funds are used by the Agency to pay for any penalties and interest.

In addition, we identified one Child Care Worker whose time sheet showed 30 hours worked, while the payroll register showed the employee was paid for 90 hours. As a result, the Child Care Worker was overpaid by 60 hours or $600 ($10 per hour x 60 hours). The Administrator indicated that she made an error in reporting the hours by the worker to the payroll processing company that resulted in the overpayment. The Administrator stated that she will inform the worker and collect back the overpaid amount.

Recommendations

15. **Fields' management consult with the IRS to determine if CCWs should be classified as employees of the Agency and ensure that the appropriate payroll taxes have been paid.**

16. **Fields' management ensure worker hours are properly reported to the payroll processing company in order to appropriately compensate each worker.**

17. **DCFS management ensure that no foster care funds are used by the Agency to pay for any penalties and interest assessed by the State Employment Development Department and the IRS if the CCWs are reclassified as employees of Fields.**

Reporting Payments to Contractors

A-C Handbook Section A.2.6 requires contractors to comply with federal and State requirements for filing 1099 (Miscellaneous Income) Forms.

We noted that the payments recorded on the general ledger for three independent contractors for calendar year 2008 did not agree with the amounts reported on the 1099s. Payments on the general ledger for two contractors were greater than the amounts reported on the 1099. For one contractor, payments on the general ledger were less than the amount reported on the 1099. Fields' management should ensure that all payments to independent contractors are accurately reported to taxing authorities.

Recommendation

18. **Fields' management ensure all payments to independent contractors are properly reported to the federal and State taxing agencies.**

Bank Reconciliations

A-C Handbook Section B.1.4 requires bank reconciliations be prepared within 30 days of the bank statement date, and reviewed by management for appropriateness and accuracy. The bank reconciliations should be signed and dated by both the preparer and the reviewer.

We reviewed the Agency's monthly bank reconciliations for two accounts (general and payroll) and noted the same findings for each account:

- Nine (75%) of the 12 bank reconciliations for each account were not prepared within 30 days of the bank statement date.

- None of the bank reconciliations were signed by the preparer or reviewer.

Recommendation

19. Fields' management ensure that bank reconciliations are prepared within 30 days of the bank statement date, and signed and dated by the preparer and reviewer.

Semi-Annual Expenditure Reports

The Group Home Contract Section 17.0 requires agencies to prepare and submit Semi-Annual Expenditure Reports to DCFS within 60 days after the end of each semi-annual reporting period.

Fields has not prepared and submitted the Semi-Annual Expenditure Reports for 2008. The Administrator provided their latest report, which covered July 1, 2007 through December 31, 2007.

Recommendation

20. Fields' management prepare and submit the Semi-Annual Expenditure Reports for 2008 to DCFS.